[JOINT COMMITTEE PRINT]

DESCRIPTION OF MISCELLANEOUS TAX BILLS

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS

ON NOVEMBER 9, 1979

PREPARED FOR THE USE OF THE

COMMITTEE ON WAYS AND MEANS

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

NOVEMBER 7, 1979

U.S. GOVERNMENT PRINTING OFFICE
53-303 O WASHINGTON : 1979 JSC-47-79

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INTRODUCTION

The bills described in this pamphlet have been scheduled for a hearing on November 9, 1979, by the Subcommittee on Select Revenue Measures of the Committee on Ways and Means.

In connection with this hearing, the staff of the Joint Committee on Taxation has prepared a description of the bills.

The first part of the pamphlet summarizes the bills in consecutive bill number order. This is followed in the second part by a more detailed description of each bill, indicating in each case the present law treatment, the issue involved, an explanation of what the bill would do, the effective date of the provision, and the revenue effect of the provision.

I. SUMMARY

1. H.R. 3874—Mr. Archer and H.R. 3561—Mr. Dicks

Waiver of Time Limits in Foreign Residence or Presence Requirement for Americans Working Abroad

The bills would permit the waiver of the minimum time limits in the foreign residence or presence eligibility requirements for Americans working abroad to obtain the benefits of the deduction for excess foreign living costs or the exclusion for foreign earned income. The waiver generally would be available to Americans working abroad who could reasonably have been expected to meet those eligibility requirements, but who left the foreign country under conditions of war, civil unrest, or similar conditions which precluded the normal conduct of business.

2. H.R. 4103—Messrs. Shannon, Bafalis, Cotter, and Kemp

Effective Date of Basis Limitation for Player Contracts Acquired in Connection with the Purchase of a Sports Franchise

Under present law, the portion of the purchase price paid for the acquisition of a sports franchise which may be allocated to depreciable player contracts is limited to the sum of the transferor's basis in the contracts and the gain recognized by the transferor with respect to the contracts. This rule was enacted by the Tax Reform Act of 1976, and was effective for sales or exchanges of franchises after December 31, 1975.

The bill would provide an exception to the effective date for certain transactions occurring before March 1, 1977, if prior to December 31, 1975, the principal stockholder of the transferee was committed to

purchase, and purchased, more than 50 percent of the voting stock of the transferor corporation. The bill is intended to benefit Mr. William H. Sullivan, Jr., and the New England Patriots Football Club, Inc.

3. H.R. 4503—Mr. AuCoin

Special Rule Relating to Debt-Financed Income of Exempt Organizations

Generally, under present law, passive investment income and gains from the sale of investments realized by an exempt organization are not subject to tax as unrelated business income. However, income and gains realized by an exempt organization from "debt-financed property" not used for its exempt function are subject to tax in the proportion in which the property is financed by acquisition indebtedness.

The bill would provide a limited exception to the debt-financed income rules. This exception would allow certain sales of real property in 1976 to be made free of the unrelated business income tax if the property had been acquired prior to 1952 and the indebtedness was incurred before 1965. The intended beneficiary of the bill is the Tillamook County YMCA of Tillamook, Oregon.

4. H.R. 4611—Messrs. Dingell and Jacobs

Charitable Deduction for Certain Contributions of Real Property for Conservation Purposes

Under present law, a deduction for a charitable contribution generally is not allowable for income, estate, and gift tax purposes for a transfer of an interest in property which is less than the taxpayer's entire interest in the property. An exception to this general rule is provided for transfers of certain leases, options, easements, and remainder interests relating to real property if transferred exclusively for conservation purposes. This exception applies to transfers made before June 14, 1981.

The bill would allow a deduction for income, estate, and gift tax purposes for the contribution of any interest in real property if (1) the taxpayer retains only mineral interests and the right of access to those minerals, and (2) the retained minerals may not be removed by any method of surface mining.

The bill also would eliminate the June 14, 1981, termination date for contributions of partial interests in real property made exclusively for conservation purposes.

5. H.R. 4634—Mr. Holland

Election to Treat Income From Spacecraft as From U.S. Sources

The bill would permit lessors of communications satellites manufactured in the United States to elect to treat their income or loss from the lease as from United States, rather than foreign, sources. This would prevent possible loss of foreign tax credits to the lessors during the early years of the lease, when depreciation and other deductions generally exceed gross income.

6. H.R. 4968—Mr. Fowler

Net Operating Loss Deduction of Former Real Estate Investment Trusts

The bill would permit trusts which were former real estate investment trusts (REITs) an additional year to carryover operating losses for each year a carryback was not allowed because it was a REIT in the carryback year. The maximum carryover period would be 8 years.

7. H.R. 5391—Mr. Ullman

Second-Tier Excise Tax on Prohibited Acts of Certain Tax-Exempt Foundations and Trusts

Under present law, a two-level excise tax system is applicable to private foundations, employee benefit trusts, and Black Lung Benefit trusts, with respect to acts prohibited for these organizations. The second-tier tax is not imposed if the prohibited act is corrected within a correction period. The Tax Court has held that it has no jurisdiction to determine a deficiency for this tax since the tax is not imposed until after its decision is final.

Under the bill, the second-tier excise tax would be imposed when a notice of deficiency is mailed to the taxpayer but would not be collectable until the end of the correction period.

II. DESCRIPTION OF BILLS

1. H.R. 3874—Mr. Archer and H.R. 3561—Mr. Dicks

Waiver of Time Limits in Foreign Residence or Presence Requirement for Americans Working Abroad

Present law

Prior to enactment of the Foreign Earned Income Act of 1978, an American who was present in a foreign country or countries for at least 510 full days during any period of 18 consecutive months, or who was a *bona fide* resident of a foreign country or countries for an uninterrupted period which included an entire taxable year, was entitled to exclude up to a flat amount (generally $20,000) per year of his foreign earned income (sec. 911).

The 1978 Act retained these eligibility requirements but changed the special provisions for Americans working abroad. Generally, qualifying individuals are allowed a deduction for their excess foreign costs of living. The new excess living cost deduction (new sec. 913) consists of separate elements for the general cost of living, housing, education, and home leave costs. In addition, taxpayers living and working in certain hardship areas are allowed a special $5,000 deduction in order to compensate them for the hardships involved and to encourage U.S. citizens to accept employment in these areas. As an exception to these new rules, the Act permits employees who reside in camps in hardship areas to elect to claim a $20,000 earned income exclusion (under

sec. 911) in lieu of the new excess living cost and hardship area deductions. As noted above, the foreign presence or residence criteria of prior law continue to determine whether or not Americans working abroad qualify for the special deduction or exclusion.

If a taxpayer working abroad is "temporarily" away from home in pursuit of a trade or business, the taxpayer may generally deduct traveling expenses (including amounts spent for meals and lodging) for himself but generally not for family members who accompany him. The taxpayer's "home" for this purpose is generally his principal place of employment. While a determination of whether the taxpayer is "temporarily" away from home depends on all the facts and circumstances, the Internal Revenue Service often holds that the taxpayer is "temporarily" away from home if his employment is not anticipated to, and does not actually, last more than a year. Otherwise, the Service ordinarily views the taxpayer as not being temporarily away from home and not entitled to these deductions.[1] A number of items in the deduction for excess foreign living costs are measured with reference to the location of the individual's tax home.

Issue

The issue is whether, in a case where an individual goes abroad with the expectation of meeting the foreign residence or presence requirements, but fails to meet those requirements because of extraordinary circumstances beyond his control, relief should be afforded from the time limitations.

Because of the recent civil unrest in Iran, a number of Americans who were working there with the expectation of meeting the foreign residence or presence requirements returned to the United States prior to the time that those requirements actually were met.

Explanation of the bills

The bills [2] would provide that, under certain circumstances, the time limits of the foreign residence or presence eligibility requirements for the deduction for excess foreign living costs or the exclusion for foreign earned income may be waived. Three conditions must be met for the waiver to apply. First, the individual must actually have been a *bona fide* resident of, or present in, a foreign country. Second, he must leave the foreign country during a period with respect to which the Treasury Department determines, after consultation with the State Department, that individuals were required to leave the foreign country because of war, civil unrest, or similar adverse conditions in the foreign country which precluded the normal conduct of business by those individuals. (These determinations may be made for any period after September 1, 1978.) Third, the individual must establish to the satisfaction of the Treasury that he could reasonably have been expected to meet the time limitation requirements. If these criteria are met, the taxpayer would be treated as having met the foreign residence or presence requirements with respect to the period during which he was a *bona fide* resident or was present in the foreign country even

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[1] Rev. Rul. 60–189, 1960–1 C.B. 60.

[2] The provisions of H.R. 3561 (Mr. Dicks) and H.R. 3874 (Mr. Archer) are identical.

though the relevant time limitation under existing law had not been met. Moreover, an individual who can establish that he could reasonably have been expected to meet the time limitation requirements would ordinarily be able to establish that his tax home was abroad for purposes of the deduction for excess foreign living costs.

Effective date

The provisions of either bill would apply to taxable years beginning after December 31, 1976, but only with respect to periods during which an individual was a *bona fide* resident of or present in a foreign country and did not meet the time limitation requirements of the foreign residence or presence tests with respect to those periods because he left the foreign country after September 1, 1978.

Revenue effect

The provisions of either bill would have no effect upon budget receipts. It forgives an unanticipated one-time tax increase of $10 million in fiscal 1980.

2. H.R. 4103—Messrs. Shannon, Bafalis, Cotter, and Kemp

Effective Date of Basis Limitation for Player Contracts Acquired in Connection with the Purchase of a Sports Franchise

Present law

Under present law, in the case of the sale, exchange, or other disposition of a sports franchise (or the creation of a new franchise), the portion of the purchase price allocated as the adjusted basis of a depreciable player contract by the purchaser cannot exceed the sum of the adjusted basis of the contract in the hands of the seller immediately before the transfer and the gain (if any) recognized by the seller from the transfer of the player contract (Code sec. 1056(a)). In the case of an acquisition from a corporation, any gain realized by the corporation with respect to a player contract but not recognized by it under the 12-month corporate liquidation rules (Code sec. 337) is taken into account in determining the purchaser's adjusted basis in the player contract to the extent recognized by the corporation's shareholders.

Under this provision, it is presumed that not more than 50 percent of the consideration paid for acquiring the franchise is allocable to player contracts unless the taxpayer can satisfy the Secretary of the Treasury that, under the facts and circumstances of the particular case, it is proper to allocate an amount in excess of 50 percent (Code sec. 1056(d)). However, the presumption does not mean that an allocation to player contracts is proper merely because less than 50 percent of the aggregate consideration is allocated to player contracts. The proper allocation depends upon the facts and circumstances of each particular case.

These rules were enacted by the Tax Reform Act of 1976, and were effective with respect to sales or exchanges of franchises after December 31, 1975, in taxable years ending after that date.

Issue

The issue is whether an exception to the effective date of present law should be provided with respect to a merger transaction involving the New England Patriots Football Club, Inc.

Explanation of the bill

The bill provides that the rules limiting the allocation of basis to player contracts in the case of a sale or exchange of a franchise after December 31, 1975, would not be applicable if the sale or exchange of the franchise was consummated before March 1, 1977, if, prior to December 31, 1975, the principal stockholder of the transferee (at the time of the sale or exchange) was committed to purchase, and purchased, more than 50 percent of the voting stock of the transferor corporation. However, the presumption that no more than 50 percent of the purchase price is allocable to player contracts (Code sec. 1056 (d)) would apply to the transaction.

The bill is intended to benefit Mr. William H. Sullivan, Jr., and the New England Patriots Football Club, Inc.

Effective date

The provisions of the bill would be effective with respect to a sale or exchange of a sports franchise after December 31, 1975.

Revenue effect

It is estimated that this bill would reduce budget receipts by $3 million. Approximately $2 million of the decrease would occur in fiscal year 1980; the remaining $1 million would affect receipts in fiscal years 1981 and 1982.

3. H.R. 4503—Mr. AuCoin

Special Rule Relating to Debt-Financed Income of Exempt Organizations

Present law

Generally, any organization which is exempt from Federal income tax (under sec. 501(a)) is taxed only on income from trades or businesses which are unrelated to the organization's exempt purposes; it is not taxed on passive investment income and income from any trade or business which is related to the organization's exempt purposes.[1]

Before 1969, some exempt organizations had used their tax-exempt status to acquire businesses through debt financing, with purchase money obligations to be repaid out of tax-exempt profits, for example, as from leasing the assets of acquired businesses to the businesses' former owners.

The Tax Reform Act of 1969 provided (in the so-called "Clay-Brown provision") that an exempt organization's income from "debt-financed property", which is not used for its exempt function, is to be subject to tax in the proportion in which the property is financed by debt. In general, debt-financed property is defined as "any property which is held to produce income and with respect to which there is acquisition indebtedness" (sec 514(b)(1)). A debt constitutes acquisition indebtedness with respect to property if the debt was incurred in acquiring or improving the property, or if the debt would not have

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[1] There are some exceptions to the general rule that passive investment income is tax-exempt. For example, social clubs (sec. 501(c)(7)) and voluntary employees' beneficiary associations (sec. 501(c)(9)) are generally taxed on such income. Also, private foundations are subject to an excise tax of 2 percent on their net investment income.

been incurred "but for" the acquisition or improvement of the property.[2]

The provisions relating to unrelated debt-financed income generally applied to taxable years beginning after December 31, 1969.[3] The 1969 Act provided a transitional rule under which the Clay-Brown rules were to apply only where indebtedness had been incurred after the date on which similar bills were introduced in the 89th Congress (June 27, 1966) until taxable years beginning after 1971. After the transition period, the new rules were applicable to all situations of investment borrowing by exempt organizations.

Issue

The issue is whether a limited exception to the debt-financed income rules should be provided for income derived from certain sales of real property during 1976 in situations where the indebtedness was incurred prior to 1965.

Explanation of the bill

The bill would provide a very limited exception to the debt-financed income rules. Under this exception, it is provided that, in applying the debt-financed income rules to any sale of real property during 1976, indebtedness incurred before January 1, 1965, by an organization to finance the construction of a building on such property shall not be treated as acquisition indebtedness if the parcel of real property on which the building was constructed (1) was acquired by the organization before January 1, 1952, and (2) is contiguous to another parcel of real property which (*a*) was acquired by the organization before January 1, 1952, and (*b*) was used by the organization for exempt purposes (for the entire period from January 1, 1952, until the date of enactment of the bill).

Although this provision may possibly benefit other taxpayers, it is primarily intended to provide tax-free treatment for a 1976 sale of real property by the Tillamook County Young Men's Christian Association (YMCA), Tillamook, Oregon. The real property sold by the Tillamook YMCA was property adjacent to property it used for carrying on its charitable and educational purposes.

Revenue effect

It is estimated that this bill would result in a one-time reduction in budget receipts of less than $50,000 in fiscal year 1980.

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[2] There are several exceptions from the term "acquisition indebtedness." For instance, one exception is indebtedness on property which an exempt organization receives by devise, bequest, or, under certain conditions, by gift. This exception allows the organization receiving the property 10 years to dispose of it free of tax under this provision, or to retain the property and reduce or discharge the indebtedness on it was tax-free income. Also, the term, "acquisition indebtedness" does not include indebtedness which was necessarily incurred in the performance or exercise of the purpose or function constituting the basis of the organization's exemption. Special exceptions are also provided for the sale of annuities and for debts insured by the Federal Housing Administration to finance low- and moderate-income housing.

[3] However, in extending the unrelated debt-financed income rule and other rules relating to the unrelated business income tax to churches, the 1969 Oct. provided that these provisions did not apply to churches for taxable years beginning before January 1, 1976.

4. H.R. 4611—Messrs. Dingell and Jacobs

Charitable Deduction for Certain Contributions of Real Property for Conservation Purposes

Present law

As a general rule, a deduction is not allowed for income, estate, and gift tax purposes for contributions to charity of less than the taxpayer's entire interest in the gift property. Exceptions allowing deductions for charitable contributions of partial interests in property are provided for the contribution of (1) a remainder interest in a personal residence or farm; (2) an undivided portion of the taxpayer's entire interest in the property; (3) certain interests in trust; and (4) interests not transferred in trust that would be deductible if made in trust. (Code secs. 170(f), 2055(e)(2), and 2522(c)(2).)

Additional exceptions for charitable contributions made "exclusively for conservation purposes" were added by the Tax Reform Act of 1976 (and modified by the Tax Reduction and Simplification Act of 1977). Under these exceptions, a deduction is permitted for the contribution to a charitable organization for conservation purposes of (a) a lease on, option to purchase, or easement with respect to real property granted in perpetuity or (b) a remainder interest in real property. (Code secs. 170(f)(3)(B) (iii) and (iv).) The exceptions for these partial interests contributed for conservation purposes only apply to contributions made before June 14, 1981.

Under section 4 of the Fish and Wildlife Improvement Act of 1978 (16 U.S.C. 742a), the Secretary of the Interior is authorized to accept gifts, bequests, or devises of real or personal property, or interests therein, for the benefit of the United States Fish and Wildlife Service. That section also provides that, for purposes of Federal income, estate, and gift taxes, such gifts, bequests, or devises are to be considered to be made to the United States. In a memorandum of July 12, 1979, the Associate Solicitor, Conservation and Wildlife, of the Department of the Interior, concluded that "contributions of partial interests in land made and received pursuant to section 4 of the Fish and Wildlife Improvement Act of 1978 are deductible under sections 170 (income tax), 2055 (estate tax), and 2522 (gift tax) of the Internal Revenue Code." However, it is understood that the Treasury Department believes this interpretation is contrary to the legislative intent of the 1978 Act.

Issues

The first issue is whether a charitable deduction should be allowed for the contribution of any interest in real property if (1) only mineral interests and the right of access to those minerals are retained by the taxpayer, and (2) the minerals retained may not be removed by surface mining.

The second issue is whether the present deduction for partial interests in real property contributed exclusively for conservation purposes should be extended to include contributions made after June 13, 1981.

Explanation of the bill

The bill would permit a deduction for income, estate, and gift tax purposes for the contribution of any interest in real property if (1)

the only interests retained by the taxpayer are oil, gas, or other mineral interests and the right of access to those interests, and (2) the retained minerals may not be removed by strip mining, open pit mining, contour mining, area mining, or any other method of surface mining.

With respect to the partial interests in real property that are presently deductible because they are contributed exclusively for conservation purposes (Code secs. 170(f)(3)(B)(iii) and (iv)), the bill would eliminate the sunset requirement that these interests must be contributed before June 14, 1981.

Effective date

The new deduction would apply to contributions or transfers made after the date of enactment.

Revenue effect

This bill would reduce budget receipts by an undetermined amount. Sufficient information is not available at this time to determine the acreage or market value of such contributions.

5. H.R. 4634—Mr. Holland

Election to Treat Income From Spacecraft as From U.S. Sources

Present law

The source of income or loss from the rental of personal property generally depends on whether the property is used inside or outside the United States. Under this rule, income from the lease of a satellite would be treated as income from sources without the United States.

Typically, under a lease financing of equipment (i.e., the equipment is purchased by a financial institution and leased to the user), the lease produces a tax loss during its early years to the lessor (primarily as a result of accelerated depreciation or amortization deductions). Where the equipment is used outside the United States, the loss arising on the lease is considered to be a foreign source loss under the generally applicable source rules. The characterization of the loss as foreign source operates to reduce the lessor's foreign source taxable income and thus its foreign credit limitation. Under certain circumstances, this may cause the lessor to lose a foreign tax credit, to which it would otherwise be entitled, for foreign taxes paid with respect to its other foreign operations. As a result, this type of lease-financing transaction could be less attractive than a lease-financing transaction involving equipment to be used exclusively in the United States.

A similar situation arose in the case of ships and aircraft which often are financed through long-term leases from financial institutions. Lessors expressed concern about the loss of foreign tax credits, and under the Revenue Act of 1971, lessors of certain ships and aircraft were given an election to treat all income and loss from the rental of the ships or aircraft as from sources within the United States (Code sec. 861(e)). Under this provision, if a taxpayer owns an aircraft or vessel which is eligible for the investment tax credit (or would be if not used by a government) and leases the aircraft or vessel to a United States person, other than a member of the

same controlled group of corporations as the taxpayer, and if the aircraft or vessel is manufactured or constructed in the United States, then the taxpayer may elect, for any taxable year ending after the commencement of such lease, to treat all amounts includible in gross income with respect to the aircraft or vessel (whether during or after the period of any such lease), including gain from sale, exchange, or other disposition of such aircraft or vessel, as income from sources within the United States. As a corollary to this rule, losses from the lease would also be treated as from U.S. sources. The election may not be revoked without the consent of the Treasury. Moreover, if the ship or aircraft is transferred in certain transactions where gain is not fully recognized, the transferee is also bound by the election.

A similar problem also arose with respect to lease-financed U.S. railroad rolling stock used temporarily in Canada or Mexico. Under the Revenue Act of 1978, lessors generally are required, on a non-elective basis, to treat all income or loss from the rolling stock as from U.S. sources if it is expected that the leased rolling stock will be used predominantly within the United States.

Property which is used predominantly outside the United States, or which is used by a government or international organization, is generally not eligible for the investment tax credit. Exceptions are made to the requirement for use in the United States for U.S. documented ships or aircraft, rolling stock of domestic railroads, and certain other property. Under the Revenue Act of 1971, this requirement is also waived for any communications satellite (as defined in section 103(3) of the Communications Satellite Act of 1962) or interest in such a satellite of a U.S. person. In addition, the 1971 Act waives the governmental use restriction for property used by the International Telecommunications Satellite Consortium (INTELSAT).

Issue

The issue is whether, and under what circumstances, income from the lease of satellites should be treated as from U.S. sources.

Explanation of the bill

The bill would permit an election to be made to treat income or losses from a lease of a spacecraft as from U.S. sources on the same basis as the election is now afforded for lease income from a ship or aircraft. Thus, the bill would apply to communications satellites because they are property eligible for the investment tax credit. However, as in the case of the present election for ships and aircraft, the satellites would have to be manufactured in the United States.[1]

Effective date

The bill would apply to spacecraft first leased by a taxpayer after December 31, 1978.

Revenue effect

This bill is estimated to have a negligible effect on budget receipts annually.

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[1] Section 7 of H.R. 4746 would make the investment tax credit available for interests of U.S. persons in communications satellites used by the International Maritime Satellite Organization, an international organization established to develop and operate a global maritime satellite telecommunications system. H.R. 4746 was passed by the House of Representatives on September 17, 1979.

6. H.R. 4968—Mr. Fowler

Net Operating Loss Deduction of Former Real Estate Investment Trusts

Present law

Prior to the Tax Reform Act of 1976, real estate investment trusts (REITs) were not allowed to carryover or carryback net operating losses. Because of the effect that this rule had during the economic downturn in the early 1970's, many trusts terminated their status as REITs in order that they could carryover net operating losses incurred by them during those years. In such a case, a trust was allowed to carryover their losses for five years. However, unlike other taxpayers, such trusts could not carryback the net operating loss to years before the loss year during which they qualified as a REIT.

The Tax Reform Act of 1976 made two changes that affected the net operating loss carryovers of corporations and REITs. First, it lengthened the time that corporations could carryover their net operating loss deductions from five years to seven years. This change was effective for losses incurred in years ending after December 31, 1975. Because of this effective date, losses incurred before 1976 by trusts which had terminated their REIT status were subject to the five-year carryforward of losses instead of the seven-year carryforward.

The Tax Reform Act of 1976 also changed the treatment of net operating losses of REITs. Under the 1976 Act, a REIT is permitted to carryforward a net operating loss for eight years. However, no net operating loss carrybacks are permitted. This change in rules was effective for taxable years of a REIT ending after October 4, 1976. As a result of this effective date, losses incurred before 1976 by REITs were subject to an eight-year carryforward if they retained their REIT status during the entire eight-year carryforward period.

Thus, where a trust which was a REIT and terminated its status in its three taxable years ending before October 4, 1976 and incurred losses in those years, less than an eight-year carryover is permitted. This is so even though the trust would have been given an eight-year carryforward had it retained its REIT status and even though it would have been given a combined eight years of carrybacks and carryforwards had the trust never become a REIT.

Issue

The issue is whether a trust, which was formerly a REIT, should be allowed an additional year of carryforward of net operating losses for each year that the trust was not permitted to carryback its net operating loss deduction because it qualified as a REIT in the year to which the loss would be carried back.

Explanation of the bill

The bill would allow a trust which was formerly a REIT an additional year of carryforward (with a maximum of eight years) of net operating losses for each year that it is denied a net operating loss carryback because it was a REIT. This would have the effect of allowing a former REIT to have a total of eight carryover years, as compared to all other corporations and qualifying REITs, even though the trust terminated its status as a REIT with the exception that it could carryover its pre-1976 net operating losses for only five years.

Effective date

The provisions of the bill would be effective for taxable years ending after October 4, 1976.

Revenue effect

This bill is estimated to reduce budget receipts by a negligible amount through 1982, $7 million in 1983, and $15 million in 1984. This estimate assumes that there is no significant increase in acquisitions under which net operating loss carryovers become available to acquiring corporations or continue to be available to corporations purchased by new owners.

7. H.R. 5391—Mr. Ullman

Second Tier Excise Tax on Prohibited Acts of Certain Tax-Exempt Foundations and Trusts

Present law

Under present law, the Internal Revenue Code contains several sections which impose a two-level excise tax system to insure the compliance of private foundations,[1] pension trusts,[2] and black lung benefit trusts [3] with certain provisions of the Code. Under each of the sections, a low-rate first-tier excise tax is imposed automatically where the foundation or trust engages in a prohibited act, and a much larger second-tier excise tax is imposed for failing to correct the prohibited act within a "correction period." The "correction period" ends after the time a court decision as to whether the taxpayer is liable for the second level tax becomes final. This system was designed to insure an adequate opportunity for court review and correction of the transaction before the Internal Revenue Service could impose and collect the second-tier tax. The second-tier taxes are intended to be sufficiently high to compel voluntary compliance without resort to actually imposing the tax.

In a recent Tax Court case,[4] the Tax Court held that the court lacked the authority to uphold a second-tier tax on a private foundation under section 4941(b). The Court found that since the second tier tax is not "imposed" until after its decision is final, it did not have jurisdiction to redetermine a deficiency of that tax. In addition, the Court noted that the "amount involved" (upon which the amount of tax is based) cannot be determined until after its decision has become final.

This decision reduces very substantially the effectivenesses of the nine sections of the Code utilizing this two-tier tax scheme to insure compliance with Congressional policy relating to private foundations, pension trusts, and black lung benefit trusts.

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[1] The provisions relating to private foundations are Code sections 4941 (self-dealing), 4942 (failure to distribute income), 4943 (excess business holdings), 4944 (jeopardy investiments), and 4945 (taxable expenditures). These provisions were added to the Code by the Tax Reform Act of 1969.

[2] The provisions relating to pension trusts are sections 4971 (minimum funding) and 4975 (prohibited transactions). These provisions were added by the Employee Retirement Income Security Act of 1974.

[3] The provisions relating to black lung benefit trusts are sections 4951 (self-dealing) and 4952 (taxable expenditures). These provisions were added by the Black Lung Benefits Revenue Act of 1977.

[4] *Adams* v. *Commissioner*, 72 T.C. No. 8 (1979)

Issue

The issue is whether the two-tier tax scheme on private foundations, pension trusts and black lung trusts should be amended in order to give the courts jurisdiction to enforce the second-tier taxes.

Explanation of the bill

The bill would impose the second-tier tax at the time the Internal Revenue Service mails a notice of deficiency to the taxpayer with respect to that tax (or when the tax is paid if no deficiency notice is mailed), rather than after the time a decision that the taxpayer is liable for the second-tier tax has become final (at the end of the "correction period") as under present law. However, under the bill, the second-tier tax would be abated if the prohibited act is corrected by the end of the "correction period." This would give the Tax Court jurisdiction to redetermine the second-tier tax while at the same time prohibiting collection of the tax during the period provided for court review and correction of the transaction.

The bill would also provide for a supplemental judicial proceeding to determine if a taxpayer has corrected within the "correction period" where the court had previously determined the taxpayer was liable for the second-tier tax. Also, the bill suspends the collection of any second-tier tax which was assessed (because a notice of deficiency was issued and no petition was filed with the Tax Court) until the taxpayer completes his administrative and judicial refund procedures.

Finally, the bill would provide that the amount of the second-tier tax in the case of the taxes on self-dealing (secs. 4941, 4951 and 4971) will be based on an "amount involved" which cannot be increased after the IRS sends out its deficiency notice.

Effective date

The bill would apply to second-tier taxes imposed after the date of enactment of the bill.

Revenue effect

This provision is not expected to have any effect on budget receipts.

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